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SIPDIS

SENSITIVE

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TAGS: EINV ECON EFIN BEXP TU
SUBJECT: GE CAPITAL ENTERS TURKISH BANKING SECTOR AS TURKS DEBATE FOREIGN OWNERSHIP

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¶1. (SBU) Summary: The August 24 announcement that GE Capital will acquire 25.5 percent of the shares of Garanti Bank, one of Turkey's four leading private banking institutions, is a welcome indication of U.S. interest in the Turkish financial sector, following a wave of European acquisitions over the past year. It will also likely intensify the ongoing debate over whether foreign investment in the sector should be limited, however, as two of Turkey's four largest private banks will henceforth have significant foreign participation. With the purchase, foreign participation in Turkish banking will rise to 18 percent, still modest in comparison to Eastern European levels, but a dramatic increase from its anemic 3 percent level last year. The purchase is the fifth announced over the last year, and even before it materialized there was a vigorous national debate and calls from some in government and opposition to limit foreigners' share in the sector to 30 percent. While the debate will continue, the deal also highlights increasing international interest in Turkish assets, as the price a major international financial institution was willing to pay for Garanti rose three-fold in a little over a year. End Summary.

¶2. (SBU) Garanti's Coup: Garanti was courted extensively in recent years by Italy's Intesa Bank, and even initialed an agreement last year. The deal ultimately foundered over pricing and other issues. Since that time, the bank has explored other options, flirting briefly with HSBC Bank and most recently with General Electric's consumer lending unit. The August 24 announcement that GE would purchase a 25.5 percent stake was thus not a surprise, but it did prove that sometimes at least, all things come to those who wait. In place of the 800 million USD that Intesa offered for 40 percent of Garanti's shares, the Dogus group will receive 1.556 billion USD for 25.5 percent of the shares, and retain five of the nine seats on the bank board. Dogus owner Ferit Sahenk will remain as Chairman and Dogus and GE will operate on the basis of an "equal partnership". Dogus will also acquire 700 million USD of Garanti's non-core assets over two years. Closure of the deal is contingent only on transfer of the bank's pension fund to the state (President Sezer earlier vetoed legislation providing for such transfer but the GOT is expected to pass it over his veto early this fall.)

¶3. (SBU) Onward and Upward: Analysts welcomed the deal both as an indication of U.S. interest in the sector, as well as for the increasing valuation for Turkish assets that it represents. Indeed, the bank's valuation has now increased three-fold, from 2 billion USD in the Intesa deal to 6.6 billion USD, a level that some Istanbul analysts characterize as "rich." This has led some leading brokerages to advise minority shareholders to sell into the tender call that GE plans on conclusion of the deal. Analysts also believe the deal bodes well for Garanti's future operations. As analyst Figen Cevik at Oyak Securities notes, beyond the benefits of partnership with GE, the transfer of non-core assets back to Dogus will "clean up the balance sheet and boost profitability in line with an improved cash equity base."

¶4. (SBU) Going, going gone: The GE deal is the latest in a string of acquisitions in the banking sector that have prompted national debate over what the appropriate level of foreign involvement should be. Over the past year, the sector has successively witnessed foreigners acquire in whole or in part a small bank (the Turkish Economy Bank-- TEB), a medium-sized bank (the Dogan Group's Disbank), a major franchise (the Cukurova Group's troubled Yapi Kredi Bank), and now a second major bank, Garanti. In total, the deals have increased the level of foreign participation in the sector from 3 to 18 percent, well on the way to BDDK Chief Bilgin's prediction last year that in the near future foreign ownership could reach a third of the sector. Only one deal has been for outright control by a foreign partner (Belguim's Fortis Bank's acquisition of Disbank). Others have involved equal partnerships-- BNP-Paribas in TEB, and now GE in Garanti. Koc-Unicredito's acquisition of Yapi Kredi stands as a hybrid case of a joint Turkish-Foreign partnership acquiring overall control of the market leader in commercial lending and credit cards. Further deals may be on the horizon, as there have been rumors of courtship between

market leader Akbank and Citibank. In public comments this week, however, Akbank board member Susan Sabanci Dincer stressed that the Sabanci group is not interested in selling off control of the bank, but only in acquiring a foreign "partner."

¶5. (SBU) Nationalist Backlash: The trend initially sparked an outcry in nationalist circles, with opponents of foreign investment such as Radikal's Yigit Bulut leading the charge. The issue was swiftly picked up by both government and opposition politicians. A recent report by the Republican People's Party (CHP) suggested capping foreign participation in the banking sector at 30 percent. This level is similar to that advocated by Deputy Prime Minister Sener earlier in the summer, though he stressed he was expressing his "personal" view. EFG Brokerage Chief Economist Baturalp Candemir observes that AK party contacts have frequently questioned him about whether it would not damage Turkey's national interests if foreign banks took over their Turkish counterparts. His AK interlocutors, he notes, have been particularly concerned about whether in a crisis foreign banks might refuse to lend to the Turkish Treasury, and whether the supply of credit to Turkish businesses wouldn't dry up. Candemir has dismissed such concerns, noting that in moments of international tension, all banks tend to have hesitation, but at the end of the day the profit-maximizing incentives are the same for foreign as for domestic banks. Candemir believes most in AK have come to accept this view, though the fact that dissension continues is evident in the continuing dialogue between Sener and BDDK Chief Bilgin over the percentage limit idea.

¶6. (SBU) Business Concern: National concerns are not totally absent even from the ranks of progressive business circles. One of our most thoughtful business contacts, Istanbul Chamber of Industry President Tanil Kucuk, notes that he personally opposes restrictions on foreign investment in any but strategic sectors, but that he concurs that it is important that two or three large banks remain Turkish to ensure that there is healthy competition between foreign and domestic participants in the sector. Overwhelming foreign predominence in banking, he suggested, might harm business as such foreign banks may not fully appreciate Turkish realities. Isbank CEO Ersin Ozince, head of the Turkish Banking Association, himself has frequently intimated that foreign ownership in the sector should be limited, saying most recently that "national capital accumulation" should be the sector's main aim, and that this should be supported by the government. Other business contacts remind us that the concern about the sale of leading Turkish banks largely reflects profound ambivalence about foreigners taking over flagship Turkish institutions, rather than opposition to new job-creating foreign investment. In this, they argue, Turkish opponents of such sales are not so different from Americans who opposed the sale of Unocal to CNCC.

¶7. (SBU) Comment: Whatever the basis of the critique, advocates of foreign direct investment, who up until earlier this year spent their time rueing its absence from Turkey, now must spend their time defending the necessity of such capital for Turkey's economic development. Increasingly, they recognize that the best defense is a good offense, and have spilled ink and taken to the airwaves to stress that Turkish capital alone is insufficient to bring Turkey the level of economic growth it needs both to raise standards of living and absorb new entrants to the labor market. Turkey's trade imbalance is another justification they have seized on. As Erdal Saglam, a prominent economic commentator in Turkey's leading paper "Hurriyet" wrote recently about the country's looming trade deficit, "a country with this large a trade imbalance cannot be against foreign investment." At the very least, however, recent sales have answered one past criticisim of such acquisitions in that foreigners are not profiting from Turkish "firesales," but instead are paying healthy premiums to take a stake in what they perceive will be a growing and profitable market. End Comment.
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